

# A REPORT TO INDIANA CITIZENS ON THE STATE'S FINANCES



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# *Auditor of State*

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Dear Indiana Citizens:

Thank you for taking the time to read this 8<sup>th</sup> semi-annual Report to Indiana Citizens on the State's Finances. My office prepares this Report to give Indiana Citizens a better understanding of Indiana government's true financial condition. This issue is devoted entirely to Indiana Government's Surplus (the General Fund and Property Tax Replacement Fund Surplus): What is it? How is it calculated? Why does it matter? Whose numbers are right? Is the State broke? If so, how does the State pay its bills? Some conclusions one can draw from this information include:

- Even though the State reported a 2004 Surplus of \$505.2 million on June 30 (Fiscal Year End), that is an illusion. The State's Fiscal Year 2004 bottom line: over a quarter billion dollars in the hole.
- That quarter billion dollar deficit is a result of the fact that, for the first time in memory, the delay of payments to schools, counties, cities and towns from state government is greater than the State's cash on hand in operating accounts on June 30.
- At first glance, the Surplus figures for the last three years might seem to suggest that Indiana government's fiscal situation has stabilized, but a closer examination taking into account payment delays, transfers, and loans demonstrates the continuation of a disturbing 5 year trend. Indiana government is again in worse shape than the year before.
- Indiana's monthly General Fund balance has been negative every month since July 2001 with the exceptions of September 30, 2001, and each June 30. Before July 2001, we have to go back to December 1993 to find another negative balance in the General Fund at month end.

This issue starts with a simple explanation of what the Surplus is, how it is calculated, and why it is important. That is followed by an explanation of some discrepancies you may have heard from different people in Indiana government and a more detailed view of where the Surplus fits in with Indiana government's entire financial picture. Finally, pages 6 and 7 again present the revenue analysis for the 2004 fiscal year.

If you have questions or comments about this publication or its contents, please e-mail me at [comments@audlan.state.in.us](mailto:comments@audlan.state.in.us), or call (317) 232-3300. You may also view this report along with other pertinent financial information on our website at [www.in.gov/auditor](http://www.in.gov/auditor).

Sincerely,  
Connie Nass  
Auditor of State

## What is the State Surplus?

**A surplus is defined as an amount or quantity in excess of what is needed.** The State Surplus can be understood as most families understand their surplus: the cash left over after their bills have been paid.

**The State Surplus is computed at the end of each budget year, June 30, when State government examines whether it spent more than it took in and sees whether it has any money left over in the General Fund, its operating account.**

In the past, our cash balance, minus outstanding purchase orders, was our Surplus. Look at the chart on this page.

**For the budget years 1999 and 2000, our cash was our Surplus.**

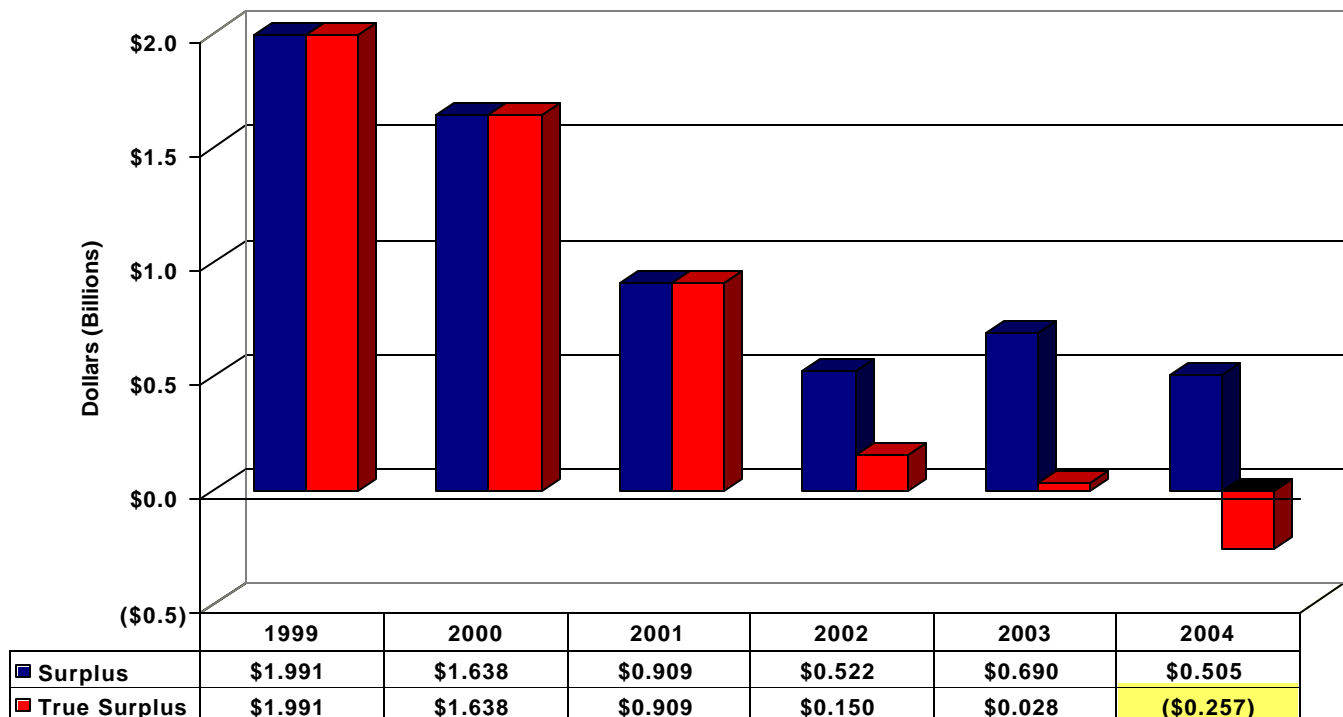
The Surplus started changing in 2001. A reserve account for Medicaid was included in the General Fund, adding \$100 million to the Surplus. This makes it harder to compare 2001 to the two years before, which did not include this reserve fund in the Surplus. Changes like this can make understanding the Surplus confusing.

More differences came the following year, 2002, when the state stopped paying some of its bills (for colleges, universities and schools) on time and dropped the Medicaid reserve account. In 2003, the state delayed those payments again and in addition delayed payments to cities, towns, and counties.

The 2004 Surplus had yet another adjustment. In addition to paying bills late, the state borrowed \$50 million to increase the Surplus. **For the first time payment delays exceeded cash on-hand making the True Surplus a deficit.**

This graph illustrates how our cash balance and our True Surplus are now different. **To create the appearance of a Surplus, the State now delays paying its bills and borrows money to show an artificially high Surplus or a Surplus where there isn't one.**

**General Fund and Property Tax Replacement Fund  
Comparison of Surplus and True Surplus**



## Why should you care about the Surplus?

The Surplus is a measure of how much money the state has left over at the end of each budget year. The change in Surplus from year to year is a measure of whether income is higher or lower than the amount spent. In order to make that comparison, it is important to know whether each year's Surplus includes the same things.

**If the Surplus is too high, government is taking more money from you than it needs. If the Surplus is at a deficit, bills are not paid on time. If the state does not have enough money to pay its bills on time, the services it provides may deteriorate, or you may be required to pay more taxes, or both.**

This chart contains a listing of all payment delays and loans included in the Surplus for the last 4 budget years.

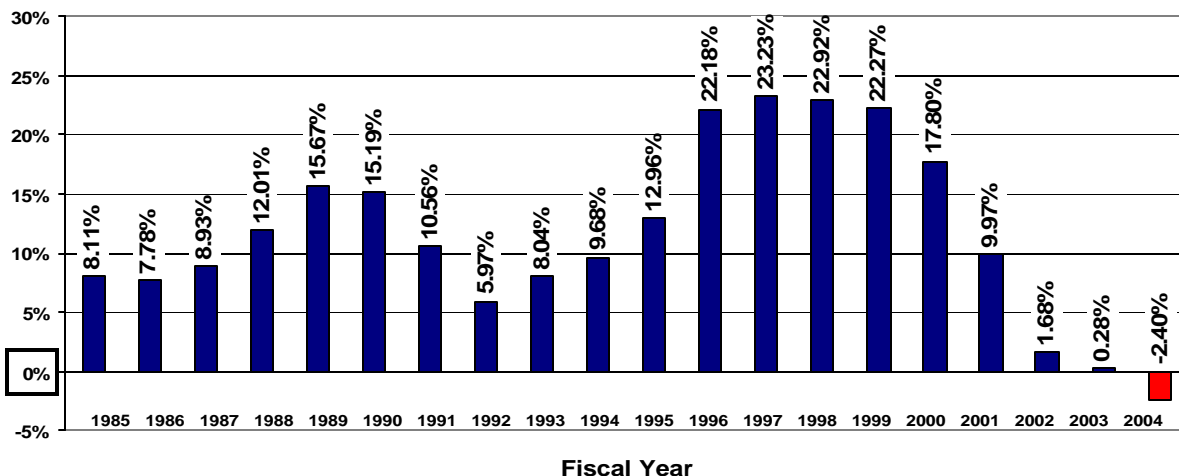
Payment Delays and Loan Payable	FY 2001	FY 2002	FY 2003	FY 2004
Property Tax Replacement Credit & Homestead Credit	\$0	0	\$ 275,551,526	\$ 323,361,260
Higher Education	0	\$ 94,930,885	96,346,369	98,226,056
Tuition Support	0	277,289,436	289,909,643	290,513,745
Loan Payable to Public Deposit Insurance Fund	0	0	0	50,000,000
Total Payment Delays and Loan Payable	\$0	\$ 372,220,321	\$ 661,807,538	\$ 762,101,061

**These delays cause your schools, counties, cities, and towns to have to borrow money and pay interest that they eventually have to take from you in higher taxes.**

It's easier to control how much money you spend than it is to make more money. But Indiana government did find more revenues in 2002 and 2003 in the form of excess balances in dedicated accounts that were then transferred to the General Fund. In 2004, the state took a \$50 million interest-free loan from the Public Deposit Insurance Fund and transferred \$70 million from the Abandoned Property Fund to supplement the General Fund's bottom line.

You are in trouble when you spend more than you earn and you don't have savings. The graph below shows our Surplus as a percent of operating revenues, adjusted for payment delays. Operating revenues consist of sales, corporate and individual income, and wagering taxes, plus miscellaneous income (see pages 6 and 7). **A bigger Surplus in relation to the percentage of operating revenues means the State can better withstand shortfalls in revenues or excess spending. A Surplus of 5% on this table is approximately two-weeks' worth of operating income. A negative percentage means there is no Surplus cash to meet current needs.**

**General Fund and Property Tax Replacement Fund  
Surplus Balance as a Percent of Operating Revenues  
(Delayed Payments are Included as if they were Paid)  
(\$50 M Loan Payable to PDIF has been Subtracted from 2004 Surplus)**



## Why do the Governor's and Auditor's numbers differ?

In addition to changes in the components of the Surplus from year to year, Hoosiers have become accustomed to hearing two different Surplus reports each July—one from the Governor and one from the Auditor.

**By state law, the Auditor of State maintains the official centralized accounting records (the general ledger) of Indiana State Government.**

The Governor's Budget Agency has in recent years included items in its Surplus statement that are different from its earlier method of computation. An example is long-term outstanding loans receivable that the Budget Agency counts as cash in the Rainy Day Fund even though the loans are not scheduled to be repaid until July 2009 at the earliest and as late as July 2013.

The following table presents the items considered by the Auditor of State in calculating the Surplus.

	FY 2001	FY 2002	FY 2003	FY 2004
General Fund Surplus	\$ 18,628,000	0	\$ 136,564,535	\$ 200,000
Reserve for Tuition Support	265,000,000	\$ 265,000,000	305,000,000	290,500,000
Rainy Day Fund	525,114,000	257,006,000	248,141,592	214,521,865
Medicaid Reserve	100,000,000	0	0	0
Surplus	\$ 908,742,000	\$ 522,006,000	\$ 689,706,127	\$ 505,221,865
Payment Delays	0	(372,220,321)	(661,807,538)	(712,101,061)
Loan Payable to PDIF	0	0	0	(50,000,000)
True Surplus	\$ 908,742,000	\$ 149,785,679	\$ 27,898,589	\$ (256,879,196)

**As mentioned above, for the past two years, the Governor's Budget Agency included as part of its Surplus outstanding loans from the Rainy Day Fund to several schools and local governments. Counting these loans as part of the Surplus inflated the 2003 figure by \$30.4 million and the 2004 figure by \$27.6 million, even though the State does not have that money.**

## Does the State have other accounts besides the General Fund?

**Yes. Although the General Fund serves as the checking account for general government operations, there are other accounts that are dedicated to specific state government functions.** The General Assembly sets up these funds for specific purposes. Revenues to many of these funds come in the form of user fees or Federal grants as opposed to taxes.

As shown in the table below, as of June 30, 2004, the General Fund held \$512,138,235 in cash and investments, minus outstanding purchase orders of nearly \$7 million. The State's dedicated accounts held balances totaling \$2.77 billion. **It is the existence of these dedicated accounts that enables state government to continue to operate even when the General Fund balance is negative.**

### Cash and Investment Balances (all funds) as of June 30, 2004

	Surplus Accounts	Dedicated Accounts	Total
General Fund Cash and Investments	\$ 297,616,370	\$ 540,424,957	\$ 838,041,327
Rainy Day Fund	214,521,865	0	214,521,865
Total General Fund Cash and Investments	512,138,235	540,424,957	1,052,563,192
Non General Fund Cash and Investments	0	2,234,269,863	2,234,269,863
Total Non General Fund Cash and Investments	0	2,234,269,863	2,234,269,863
Grand Total All Funds Cash and Investments	\$ 512,138,235	\$ 2,774,694,821	\$ 3,286,833,055

## If the State is broke, how do we pay our bills?

The General Fund, which serves as state government's checking account, is out of money. **The General Fund has been in a negative position at the end of every month since July 2001 with the exceptions of September 2001 and June 30 each year when the state closes its books.** This is reflected in the graph below. The blue bars reflect a positive balance in the General Fund. The red bars reflect a negative balance in the General Fund. **The General Fund month-end balance was positive for every month-end since December 1993 through June 2001.**

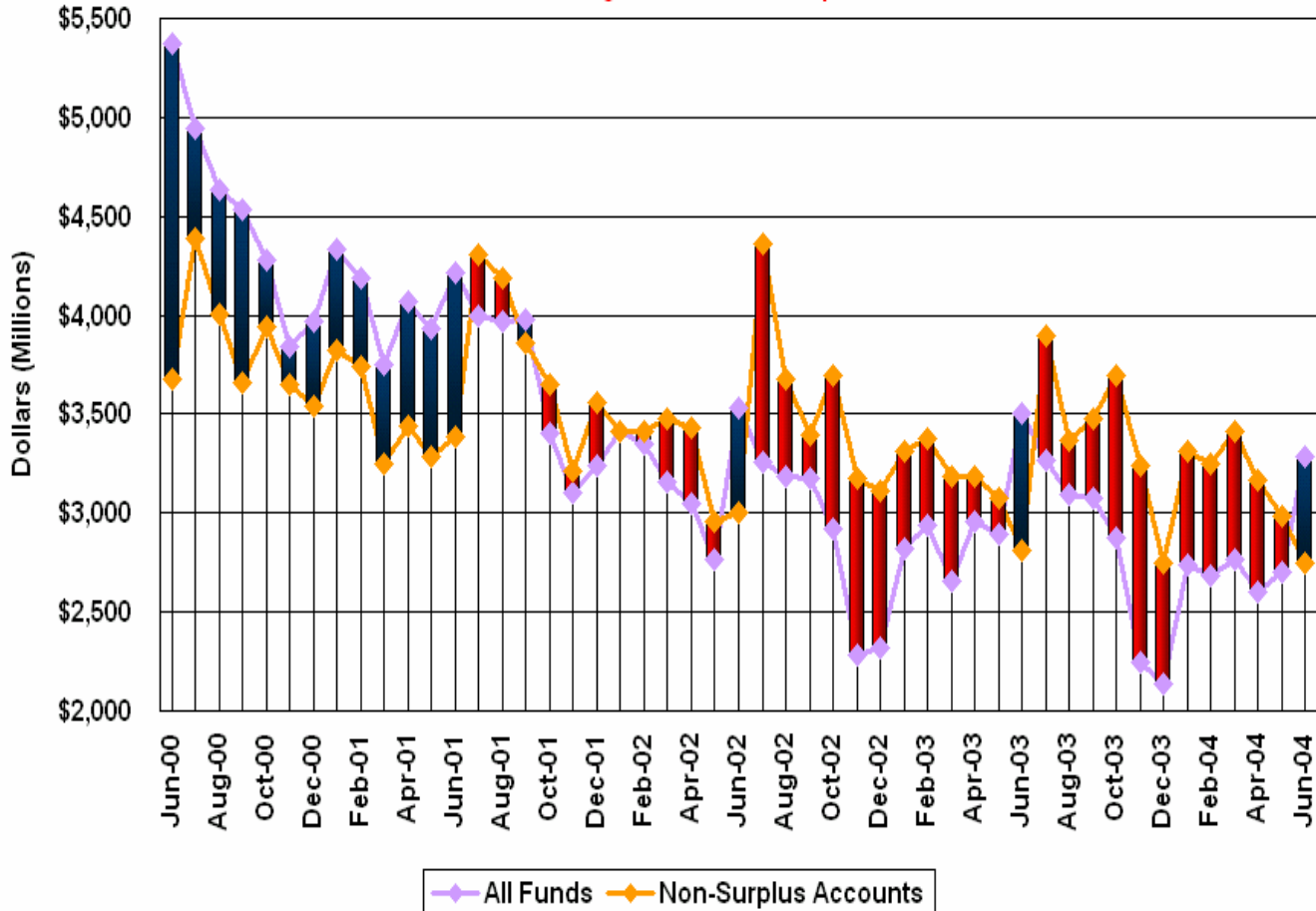
The area underneath those bars represents the remainder of the state's cash and investment balances outside the General Fund in dedicated accounts. These dedicated accounts are established and the funds in them earmarked for specific purposes as indicated in the previous page. **When the General Fund is in a negative position, the state is in effect borrowing money from those dedicated accounts to meet its day to day obligations.**

There were times throughout the years when those balances dropped to levels significantly lower than we have seen in the past. In December of the past two years, there have actually been days when the total cash and investment balances have fallen below \$2 billion.

**Treating these dedicated funds as a revolving pool of available cash may work in the short-term, but in the long-run the money will have to be paid back,** or the State will face a situation where it is literally unable to pay its bills, let alone pay them on time.

### State of Indiana Cash and Investment Balance Analysis

Blue Bars Show Positive Cash in The Surplus Account  
Red Bars Show Negative Cash in The Surplus Account



## General and Property Tax Replacement Fund Revenue Trends (Cash Basis)

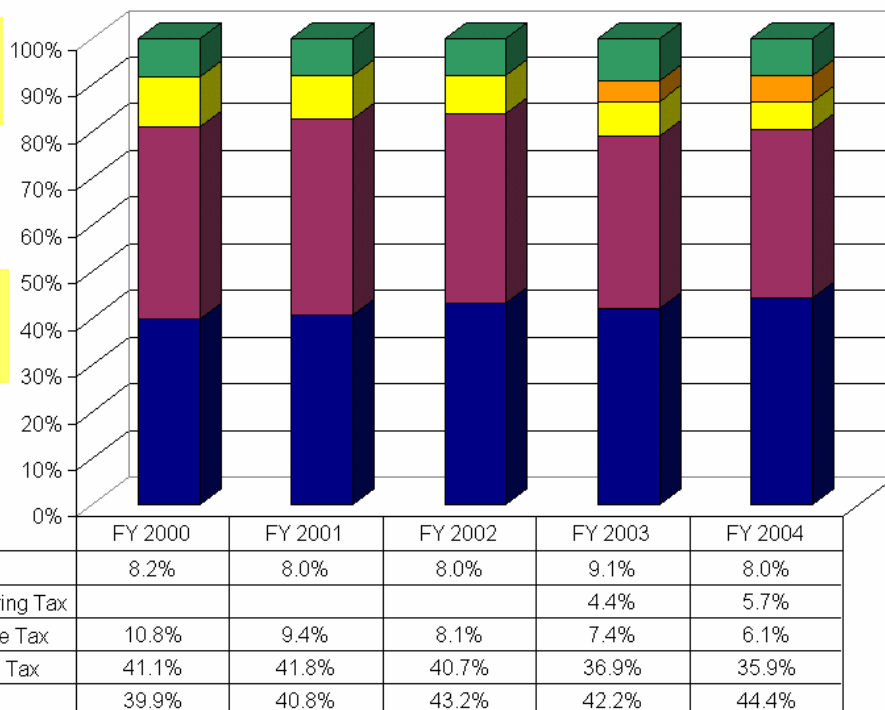
### A Detailed Analysis of the Four Primary Revenue Sources

The General Fund and Property Tax Replacement Fund ("Funds") receive revenue from sales tax, individual income tax, corporate income tax, riverboat wagering tax, and 8% from various other revenue sources. During fiscal year 2003, the General Assembly increased the sales tax by 20% and earmarked riverboat wagering tax for the Funds, thereby changing the revenue mix. In fiscal years 2000 through 2003, sales, individual, and corporate taxes remained stable, accounting for approximately 92% of revenues. By June 30, 2004, that percentage had decreased to 86.3%. **Riverboat taxes are a major revenue source for the Funds, approaching and at times exceeding corporate income taxes.**

General and Property Tax Replacement Fund Revenue Percentage by Type

#### Total Budgeted Revenues

**For FY 04 revenue totaled \$10.6 billion – a \$740.9 million (7.5%) increase over FY 03 revenue.** This was \$59.4 million (0.7%) greater than the January 12, 2004 revised revenue forecast ("Revised Forecast") but **\$71.4 million (0.6%) below the April 10, 2003 forecast ("Budget Forecast")** used in preparing the State's biennial budget. The Economic Forecast Committee prepares the revenue forecasts.



#### Sales Tax

For fiscal year 2004, sales taxes accounted for 44.4% of General Fund and Property Tax Replacement Fund ("General Fund") revenue.

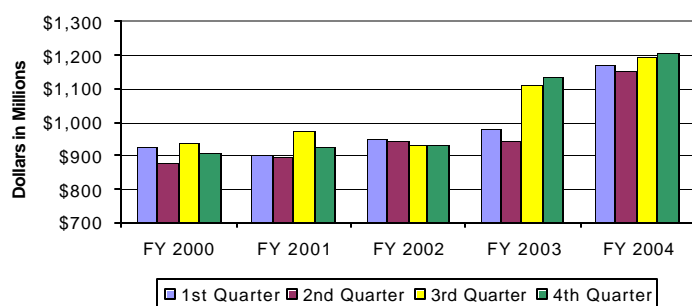
**For FY 04, sales tax receipts were \$548.5 million (13.1%) higher than FY 03.** The largest portion of the increase came in the first half of FY 04 because the 20% increase in the tax rate from 5% to 6% became effective December 1, 2002, which was just before the start of the second half of FY 03. **Although receipts exceed the Revised Forecast by \$5.0 million (0.1%), sales tax receipts were \$162.2 million (3.3%) below the Budget Forecast.**

#### Sales Tax

(Dollars in Millions)

	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
1st Quarter	928.1	903.9	953.1	978.9	1,172.8
2nd Quarter	877.1	895.3	942.3	945.6	1,152.0
3rd Quarter	936.9	970.1	933.3	1,111.7	1,193.1
4th Quarter	909.3	924.6	932.7	1,136.4	1,203.0
Total	3,651.4	3,693.9	3,761.4	4,172.6	4,720.9

#### Sales Tax Collections



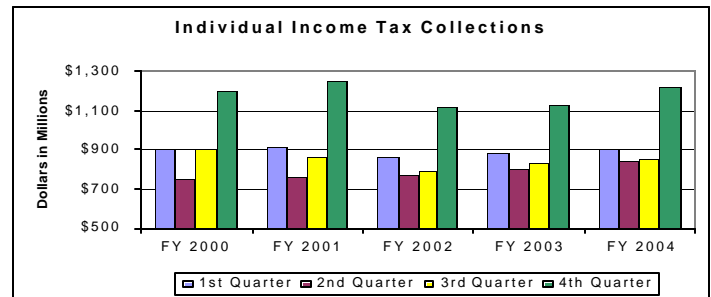
# General and Property Tax Replacement Fund Revenue Trends (Cash Basis)

## A Detailed Analysis of the Four Primary Revenue Sources (Continued)

### Individual Income Tax

**Individual income taxes were 35.9% of General Fund revenue for FY 04.** Collections for FY 04 were \$163.6 million (4.5%) greater than FY 03 collections. After increasing \$26.5 million from FY 00 to FY 01, individual income tax collections dropped \$239.0 million by the end of FY 02. FY 03 and FY 04 collections have each been higher than the previous year. Although FY 04 collections increased over FY 03, they were still only \$28.1 million (0.7%) greater than at the high point in FY 01. **FY 04 collections were \$27.3 million (0.7%) above the Revised Forecast and \$31.3 million (0.8%) below the Budget Forecast.**

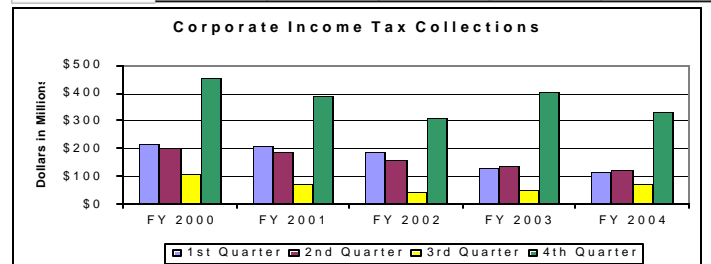
Individual Income Tax (Dollars in Millions)					
	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
1st Quarter	901.5	912.6	860.2	884.7	904.0
2nd Quarter	745.5	762.1	770.8	799.7	841.6
3rd Quarter	906.5	859.3	793.7	832.8	845.4
4th Quarter	1,199.8	1,245.8	1,116.1	1,127.1	1,216.9
Total	3,753.3	3,779.8	3,540.8	3,644.3	3,807.9



### Corporate Income Tax

**Corporate income taxes continue to decline.** For FY 04 they totaled \$644.8 million (6.1%) of General Fund revenue, which compares to \$985.3 million (10.8%) of General Fund revenue in FY 00. FY 04 collections were \$36.4 million (6.0%) above the Revised Forecast and \$86.2 million (15.4%) above the Budget Forecast. Several provisions of the corporate income tax law were changed during the 2002 special session of the General Assembly. That legislation has in part been a factor in the decline of \$482.6 million in corporate income tax collections since FY 01. **Using FY 01 as a base, the State lost Corporate Income Tax revenue of \$145.9 million in FY 02, \$126.2 million in FY 03, and \$210.5 million in FY 04.**

Corporate Income Tax (Dollars in Millions)					
	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
1st Quarter	220.4	205.6	189.8	132.3	114.2
2nd Quarter	199.7	187.9	164.5	140.5	125.8
3rd Quarter	108.6	75.7	44.2	50.2	73.9
4th Quarter	456.6	386.1	310.9	406.1	330.9
Total	985.3	855.3	709.4	729.1	644.8



### Riverboat Wagering Tax

**Riverboat wagering tax accounted for 5.7% of the General Fund revenue in FY 04 compared to none in FY 02. Prior to FY 03 the State's share of the riverboat wagering tax was deposited into the Build Indiana Fund.** Starting with FY 03 the State's share of the riverboat wagering tax is deposited into the Property Tax Replacement Fund. At the end of each fiscal year beginning with FY 03, funds are transferred to the Build Indiana Fund to bring its revenue total to \$250 million. In FY 03 \$136,209,071 was transferred while \$106,523,997 was transferred in FY 04. **The State's and local government's shares of riverboat wagering tax for fiscal years 2000 – 2004 were as follows:**

FY 2000	\$246,114,118 State,	\$ 82,038,039 Local
FY 2001	\$260,193,774 State,	\$ 84,098,718 Local
FY 2002	\$285,139,922 State,	\$ 95,046,641 Local
FY 2003	\$430,886,277 State,	\$ 95,046,641 Local
FY 2004	\$601,547,172 State,	\$128,046,641 Local

Riverboat Wagering Tax (Dollars in Millions)			
	Prior to fiscal year 2003 riverboat wagering taxes were not deposited into the General and Property Tax Replacement Fund.	FY 2003	FY 2004
1st Quarter		49.4	114.0
2nd Quarter		86.2	114.6
3rd Quarter		118.3	175.9
4th Quarter		176.9	197.0
Total		430.8	601.5

